TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM [redacted] 1962

No. [redacted] 78

CHESTER A. PEARLMAN, TRUSTEE,
PETITIONER,

vs.

RELIANCE INSURANCE COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 5, 1962
CERTIORARI GRANTED APRIL 16, 1962

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1961

No. 771

CHESTER A. PEARLMAN, TRUSTEE,
PETITIONER,

vs.

RELIANCE INSURANCE COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

RECORD PRESS, PRINTERS, NEW YORK, N. Y., JUNE 29, 1962

[fol. A] [File endorsement omitted]

[fol. 1]

Appendix of Appellant—Filed November 16, 1961

PROCEEDING IN BANKRUPTCY

IN UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In the Matter

of

DUTCHER CONSTRUCTION CORPORATION, Bankrupt.

In Bankruptcy No. 41068

Attorneys:

For Reliance Insurance Company—Vaughan, Brown, Kelly, Turner & Symons, 440 M & T Building, Buffalo 2, New York.

For Chester A. Pearlman, Trustee in Bankruptcy of Dutcher Construction Corporation, Bankrupt—Raymond T. Miles, 942 Ellicott Square Building, Buffalo 3, New York.

SHOW CAUSE ORDER DATED SEPTEMBER 21, 1959

Upon the petition of Reliance Insurance Company (formerly Fire Association of Philadelphia), verified September 4, 1959,

Let the Trustee, creditors and others interested in the estate of the named bankrupt show cause before the [fol. 2] Bankruptcy Court herein, at Room 416 United States Court House, Niagara Square, in the City of Buffalo, New York, on the 14 day of October, 1959, at 10:00 o'clock in the forenoon of that day, why an order should

not be made directing the Trustee herein to pay over forthwith to said petitioner the sum of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35) being the proceeds of a payment by the U. S. Engineers, received and now held by the Trustee herein, covering work, labor and services rendered and performed by the bankrupt herein on the St. Lawrence Seaway Prime Contract, known as Contract No. DA-30-023-eng-339, and on which the petitioner was surety for said bankrupt, and why said petitioner should not have such other, further and different relief as to this Court may seem just and proper.

Dated: Buffalo, New York, September 21, 1959.

James R. Privitera, Referee in Bankruptcy.

IN UNITED STATES DISTRICT COURT

PETITION OF RELIANCE INSURANCE COMPANY

The petition of Reliance Insurance Company (formerly Fire Association of Philadelphia) respectfully shows:

That it is an insurance corporation duly organized and existing under and by virtue of the laws of the Commonwealth of Pennsylvania, with its principal office and place of business located at 401 Walnut Street, Philadelphia, [fol. 3] Pennsylvania. That the name of the corporation, prior to January 1, 1958, was Fire Association of Philadelphia, and is hereinafter referred to as the "Surety".

That heretofore and on or about November 19, 1951, the Dutcher Construction Corporation, the bankrupt herein, made, executed and delivered to the Surety its certain General Indemnity Agreement, a copy of which is annexed hereto, marked Exhibit "A", and made a part hereof.

That on or shortly prior to April 11, 1955, the bankrupt applied to the Surety for payment and performance bonds in connection with a prime contract then about to be entered into between the bankrupt and the United States of America, Corps of Engineers, relating to the St. Lawrence Seaway, and known as Contract No. DA-30-023-eng-339.

That in reliance upon Exhibit "A", the Surety, as surety for said bankrupt and not otherwise, on or about April 11, 1955, made, executed and delivered the payment and performance bonds herein referred to, a copy of which Performance Bond is attached hereto, marked Exhibit "B", and a copy of which Payment Bond is attached hereto, marked Exhibit "C", and both of which are made a part hereof.

That upon the furnishing to and filing with the Corps of Engineers of said payment and performance bonds, the bankrupt was duly awarded said prime contract and entered upon the performance thereof.

That thereafter, and on or about April 11, 1956, the United States of America, with the consent of said bankrupt, terminated the aforesaid prime contract of April [fol. 4] 11, 1955, and that on or about August 30, 1956, the bankrupt was adjudicated a bankrupt by this Court.

That the bankrupt, during its prosecution of said contract and prior to its determination on April 11, 1956, as aforesaid, incurred various bills for labor, materials and services in the performance of its said prime contract, which were covered by the Surety's payment bond, and that prior to April 11, 1956, said bankrupt was in default in the payment of substantial portions of said bills and obligations covered by the Surety's said payment bond.

That during the spring and summer of 1956, various demands were made upon the Surety by the several creditors of the bankrupt who were covered by said payment bond, and that pursuant to said demands and in discharge of its obligations and duties under said payment bond, the Surety paid to said beneficiaries under said payment bond the sum of Three Hundred and Twenty-Six Thousand Two Hundred Forty-Eight Dollars and Forty-Two Cents ($326,248.42) and, in addition thereto, incurred and paid expenses in connection therewith, in the sum of Twenty Thousand Seven Hundred Fifty-Four Dollars and Thirty-Four Cents ($20,754.34), making a total of Three Hundred Forty-Seven Thousand Two Dollars and Seventy-Six Cents ($347,002.76).

That in addition to the foregoing, the Surety paid, in response to a judgment secured against it in the United States District Court for the Northern District of New York, the sum of Eighteen Thousand Eight Hundred Seventy-Eight Dollars and Forty-Seven Cents ($18,878.47) for tires furnished to the bankrupt for use on said prime contract, by which judgment said Court held the Surety [fol. 5] liable therefor, and the further sum of Four Thousand Forty-Five Dollars and Ninety-Two Cents ($4,045.92) to Credle Equipment, for which the Surety was liable under said payment bond, making a total of claim payments of Three Hundred Forty-Nine Thousand One Hundred Seventy-Two Dollars and Eighty-One Cents ($349,172.81).

That the bankrupt, prior to the termination of its prime contract on April 11, 1956, had earned in performance thereof sums in excess of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35); that out of the sums so earned by the bankrupt the United States of America, acting through the Corps of Engineers, paid, satisfied and discharged all its claims and demands relating to all work performed by the bankrupt, and that during the summer of 1959 said United States of America paid to the Trustee in Bankruptcy of the bankrupt the sum of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35) for work performed by the bankrupt on said prime contract prior to April 11, 1956, which said sum the Trustee in Bankruptcy of the bankrupt now holds.

That subsequent to the bankruptcy of the bankrupt, and within the time required by law, and on or about March 22, 1957, the Surety duly filed its claim against the bankrupt herein with the Referee in Bankruptcy of this Court, to which reference is hereby made, and which is incorporated herein by reference as though fully set forth herein.

That in and by said claim the Surety asserted a first priority: 1) in the aforesaid sum of Three Hundred Forty-Seven Thousand Two Dollars and Seventy-Six Cents [fol. 6] ($347,002.76), together with 2) such additional sums as it might pay or be compelled to pay in the discharge

of its obligations under the aforesaid payment bond, which amount was, at the time of filing said claim, contingent and unliquidated, but which has now become liquidated and fixed, at least to the extent of the payment of said judgment, in the aforesaid sum of Eighteen Thousand Eight Hundred Seventy-Eight Dollars and Forty-Seven Cents ($18,878.47), and the further sum of Four Thousand Forty-Five Dollars and Ninety-Two Cents ($4,045.92), as aforesaid.

That in and by said proof of claim the Surety further asserted:

> "That as to the aforementioned debt, both liquidated, unliquidated and contingent, this creditor claims and asserts it is entitled to priority in the payment thereof, including by way of liens, subrogation and assignment, from the following sources:
>
> 1. Unpaid contract balances, including all estimates, retainages, extras, claims for changed conditions, damages and final estimates unpaid under the bankrupt's aforesaid prime contract with the United States of America, Corps of Engineers, as aforesaid, together with any and all other recoveries, if any, made by the Trustee in Bankruptcy herein on behalf of said bankrupt, growing out of or pertaining in any manner to the aforesaid prime contract with the United States of America, Corps of Engineers."

That by virtue of the foregoing, the Surety is the owner of said sum of Eighty-Seven Thousand Seven Hundred [fol. 7] Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35), free and clear of the claims of the Trustee in Bankruptcy or any other person, firm or corporation, and is entitled to have said sum paid to it forthwith.

Wherefore, your petitioner, the Surety herein, respectfully asks that an order be granted herein requiring the Trustee in Bankruptcy herein, and all such other persons as this Court shall determine are entitled to notice of this application, to show cause why an order should not be

made directing the Trustee in Bankruptcy herein to pay over forthwith to the Surety the aforesaid sum of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35), and why your petitioner, the Surety herein, should not have such other, further and different relief as to this Court may seem just and proper.

Dated: September 4th, 1959.

Reliance Insurance Company, By Addison Roberts, Its Vice President.

Duly sworn to by Addison Roberts, jurat omitted in printing.

[fol. 8]

EXHIBIT "A" TO PETITION

FIRE ASSOCIATION OF PHILADELPHIA

GENERAL INDEMNITY AGREEMENT

WHEREAS, the undersigned, hereinafter called Indemnitors, have requested, and may hereafter request, the FIRE ASSOCIATION OF PHILADELPHIA, a corporation duly incorporated under the laws of the State of Pennsylvania, hereinafter called the Company to execute and procure the execution of various and sundry bonds, undertakings and recognizances (all of which will hereafter be included within the term bond) as have been, and such as may hereafter be, applied for, whether by formal application or orally or by letter or otherwise, directly or through any agent, attorney or other representative, by the Indemnitors or any one or more of them; and the Company upon the express condition that this instrument be executed, and in consideration thereof, has executed or procured the execution [fol. 9] of, and may from time to time hereafter execute or procure the execution of, such bond or bonds, it being understood that all such bonds shall be covered hereunder, whether or not it is specifically so stated or agreed at the time the application is made.

NOW, THEREFORE, in consideration of the premises and the sum of One Dollar ($1.00) this day paid by the Company to each of the Indemnitors receipt of which is hereby acknowledged, the Indemnitors, and each of them, for themselves, their and each of their heirs, executors, administrators, successors and assigns, jointly and severally, do hereby covenant and agree:

1. To pay or cause to be paid to the Company, as a consideration for becoming surety on such bond or bonds, an annual premium or charge upon each bond, to be computed at such rate as may be agreed upon by the Indemnitor and the Company. Such premium shall be paid in advance on the date of execution of any such bond and shall not be subject to any reduction in amount, and all subsequent premiums shall be paid annually thereafter in advance on the corresponding date of succeeding years, as long as the Company shall remain liable, and until it shall have been fully discharged and released from any and all liability upon such bond or bonds and all matters in any wise incident thereto, and until there shall have been furnished to the Company, at its Home Office in the City of Philadelphia, due and satisfactory proof, by evidence legally competent, of such discharge and release.

2. To indemnify the Company from and against any and all liability, loss, costs, damages, attorneys' fees and [fol. 10] expenses of whatever kind or nature which the Company may sustain or incur by reason or in consequence of executing any such bond or bonds as surety or co-surety or procuring, upon its full indemnity, the execution thereof as aforesaid, and which it may sustain or incur in making any investigation on account of any such bond or bonds, in defending or prosecuting any action, suit or other proceeding which may be brought in connection therewith, in obtaining or attempting to obtain a release from liability under any such bond or bonds, and, if any such bond be a bail bond in locating, extraditing and surrendering the person bailed; and to indemnify the Company to the full amount of liability, loss, costs, damages, attorneys' fees and expenses as aforesaid regardless of any reinsurance that may be carried on such bond or bonds, it being the

object and intent hereof that this instrument shall protect, in the name of the Company, any and all surety or reinsuring companies that may assume reinsurance upon any such bond or bonds; and in like manner, to indemnify such other surety or sureties as the Company has procured or may procure, otherwise than upon its full indemnity, to execute or to join with it in executing any such bond or bonds, it being agreed that this instrument shall inure to the benefit of any such surety or sureties, so as to give it or them a right of action hereunder.

3. That any property of any kind which may have been, or may hereafter be, pledged as collateral security on any one or more of such bonds may, at the option of the Company, be retained as collateral security on any or all bonds coming within the scope of this agreement, whether theretofore or thereafter executed and whether executed by the [fol. 11] Company or any other surety or sureties, and for the full and complete performance in all respects of the covenants of the Indemnitors under this agreement; and in case of any breach of the covenants of the Indemnitors, or in case the Company should deem it advisable to raise money for the purpose of meeting any actual or prospective claim or demand under any such bond or bonds or to pay any expenses incurred or to be incurred in connection therewith, or in case the Company should be of opinion that said property is likely to so decline in market value that the security to the Company will be inadequate, the Company shall have full power and authority, without notice to the Indemnitors or any of them, to sell, assign and deliver said collateral, or any part thereof, at public or private sale, at the option of the Company, its successors or assigns, with the right to be the purchaser itself at any such public sale, and to use all of the proceeds, or such part thereof as may be necessary, in order to protect itself and any other surety or sureties executing any such bond or bonds against loss, costs, damages, attorneys' fees and expenses as aforesaid; and after deducting all legal and other costs and expenses of such sale, and all such loss, costs, damages, attorneys' fees and expenses as aforesaid, and all premiums due the Company or any such surety or sureties for any such bond or bonds, shall return the remainder

of such collateral or the proceeds of sale, if any, to the person or persons legally authorized to receive the same; provided the Company shall not be responsible for any loss resulting to the said property from any cause other than the act or neglect of its officers or employees.

4. That the Company, surety or sureties executing any such bond or bonds shall have the right, and such Com- [fol. 12] pany, surety or sureties are hereby authorized, but not required—

a. If any such bond or bonds be given in connection with a contract, to consent to any extensions, modifications, changes or alterations of, or additions to, the contract and the plans and specifications therein referred to, and from time to time make advances or loans to the principal for the purposes of the contract, without the necessity of seeing to the application thereof, it being hereby agreed that the amount of such advances or loans shall be conclusively presumed to be a loss hereunder; and to take possession of the work under such contract in event of any abandonment or forfeiture of such contract or of any breach thereof or of such bond or bonds, and, at the expense of the indemnitors, to complete, or to contract for the completion of, the same, or to consent to the re-letting or completion thereof by the owner;

b. If any such bond or bonds be filed in, or given in connection with a suit, action or proceeding in any court, to recognize any attorney or attorneys appearing of record in such suit, action or proceeding for any party thereto at the date of the execution of said bond or bonds, as the authorized representative of said party or parties with full and ample authority to act for such party or parties throughout such suit, action or proceeding and throughout any and all appeals therein, until the Company, surety or sureties shall have been fully discharged from liability under said bond or bonds;

[fol. 13] c. From time to time to increase or decrease the penalty or penalties of said bond or bonds, to

change the obligee or obligees therein and to execute, from time to time, any continuances, enlargements, modifications and renewals of any such bond or bonds, or any substitutes therefor, with the same or different conditions, provisions and obligees, and with the same or larger or smaller penalties, it being hereby agreed that this instrument shall, in all its terms, apply to and cover any and all such new or changed bonds or renewals.

d. To take such steps as it or they may deem necessary or proper to obtain release from liability under any such bond or bonds, including the right, if said bond be a bail bond, to surrender the person bailed at any time either before or after default;

e. To adjust, settle or compromise any claim, demand, suit or judgment upon any such bond or bonds, unless the Indemnitors shall request such Company, surety or sureties to litigate such claim or demand, or to defend such suit, or to appeal from such judgment, and shall, simultaneously with such request, deposit with such Company, surety or sureties collateral satisfactory to it or them, sufficient to pay any judgment or judgments rendered, or that may be rendered, with interest, costs, expenses and attorneys' fees.

5. If any such bond be given in connection with a contract, to assign, transfer and set over, and the Indemnitors do hereby assign, transfer and set over, to the Company, surety or sureties executing said bond or bonds, such as- [fol. 14] signment to become effective as of the date of said bond or bonds, but only in the event of any such abandonment, forfeiture or breach as aforesaid—

a. All their right, title and interest in and to all machinery, plant, tools and materials which are now or may hereafter be upon the site of the work embraced in such contract, or elsewhere for the purposes thereof, including all materials purchased or ordered for said contract, whether such materials be completely manufactured or not;

b. All their right, title and interest in and to any and all subcontracts let or which may be let in connection with such contract;

c. Any and all percentages of the contract price retained on account of said contract, and any and all sums that may be due under said contract at the time of such abandonment, forfeiture or breach, or that thereafter may become due;

d. All their rights in, and growing in any manner out of, said contract or said bond or bonds.

6. That liability hereunder shall extend to and include the full amount of any and all money paid by the Company, surety or sureties executing any such bond or bonds in settlement or compromise of any claims, suits, and judgments thereunder in good faith under the belief that it or they were liable therefor, whether liable or not, as well as of any and all disbursements on account of costs, attorneys' fees and expenses as aforesaid, which may be made under the belief that such were necessary, whether necessary or not.

[fol. 15] 7. That in the event of payment, settlement or compromise of liability, loss, costs, damages, attorneys' fees, expenses, claims, demands, suits and judgments as aforesaid, in connection with any such bond or bonds, an itemized statement thereof, sworn to by an officer or officers of the Company, surety or sureties making such payment, settlement or compromise, or the voucher or vouchers, or other evidence of such payment, settlement or compromise, shall be *prima facie* evidence of the fact and extent of the liability of the Indemnitors in any and all claims or suits hereunder.

8. That in the event the Company, surety or sureties executing any such bond or bonds should deem it necessary or proper, in order to comply with the law or with the regulations of the Insurance Department of any State, to set aside as loss reserve an amount to cover any judgment that may have been rendered against the principal, with interest and costs, or to cover any unadjusted claim or claims under said bond or bonds, the Indemnitors will,

immediately upon demand and notwithstanding any further proceedings that may have been taken, or that may be contemplated, by the principal, and notwithstanding the pendency of any appeal, deposit with said Company, surety or sureties an amount of money sufficient to cover such judgment, with interest and costs, or such claim or claims, such sums to be held by said Company, surety or sureties as collateral security on said bond or bonds, with the right on the part of the Company, surety or sureties at any time to use such sum, or any part thereof, in the payment of such judgment or in the settlement of such claim or claims; and the said Indemnitors, in the event of their [fol. 16] failure to comply with such demand, hereby authorize and empower any attorney of any court of record in the United States, or any of its territories or possessions, to appear for them or any of them in any suit or suits by the Company, surety or sureties executing said bond or bonds and to confess judgment against them or any of them for any sum or sums of money up to the amount of said bond or bonds, with costs and interest and a reasonable attorneys' fee; such judgment, however, to be satisfied upon the payment of any and all such sums as may be found to be due by the Indemnitors to such Company, surety or sureties under the terms of this agreement. Demand upon the Indemnitors shall be sufficient if sent by registered mail to each Indemnitor at the address given by him or her to the Company or at his or her address last known to the Company, whether actually received or not.

9. That if the Company, surety or sureties executing any such bond or bonds shall bring suit, action or proceeding to enforce any of the covenants or agreements herein contained, the costs, charges and expenses, including attorneys' and counsel fees incurred by such Company, surety or sureties in prosecuting such suit, action or proceeding shall be included in any judgment or decree that may be rendered against the Indemnitors therein.

10. To waive and do hereby waive—

a. All right to claim any of their property, including homestead, as exempt from levy, execution or sale, or other legal process, under the laws of any State or States;

b. Any defense based upon the execution of this agreement subsequent to the date of any such bond or [fol. 17] bonds, the Indemnitors admitting and covenanting that the execution of any such bond or bonds by the Company, surety or sureties was in pursuance of the previous request of the Indemnitors;

c. Notice of any breach, or breaches of any such bond or bonds or of any contract or contracts in connection with which such bond or bonds may have been given, or any act or default that may give rise to claim hereunder;

d. Any right to ask or require the Company, surety or sureties executing any such bond or bonds to remove or join in any application for the removal of any proceeding from a State court to a Federal court;

e. Notice of the acceptance of this obligation and of execution of any such bond or bonds;

f. The execution of this instrument by the principal.

11. That nothing herein contained shall be considered or construed to waive, abridge or diminish any right or remedy which the Company, surety or sureties executing any such bond or bonds might have if this instrument were not executed.

12. That the liability of the Indemnitors hereunder shall not be affected by any alleged agreement or promise, written, oral or implied, for other indemnity, or for other security by collateral or otherwise; nor by the release of any indemnity or security that may have been taken by, or the return or exchange of any collateral that may have been deposited with the Company, surety or sureties exe- [fol. 18] cuting any such bond or bonds, the Indemnitors hereby consenting to any such release, return or exchange; and if any Indemnitor signing this agreement is not bound for any reason or is or shall become released, this obligation shall still be binding upon each and every other Indemnitor, and the liability of the Indemnitors hereunder shall continue so long as the liability of the Company, surety or sureties under such bond or bonds shall continue and

until satisfactory evidence of discharge or release of such liability shall have been furnished to the Company.

13. That separate suits may be brought hereunder as causes of action accrue, and suit may be brought against all of the Indemnitors or any one or more of them; and the bringing of suit or suits upon one or more causes of action, or against one or more of the Indemnitors, shall not prejudice or bar the bringing of subsequent suits against all of the Indemnitors, or any one or more of them on any other cause or causes of action, whether theretofore or thereafter accruing.

14. That the Company is not obligated to execute any such bond or bonds or procure the execution thereof either upon its full indemnity or otherwise; and any attempt on the part of the Company to secure co-suretyship or reinsurance on any such bond or bonds shall be as agent for the Indemnitors and such attempt shall not impose upon the Company any separate and independent liability whatsoever.

15. This agreement, being based upon a valuable consideration, is to be construed according to the rules applicable to the construction of obligations given by compensated sureties.

[fol. 19] IN TESTIMONY WHEREOF, the Indemnitors have hereunto set their hands and affixed their seals this 19 day of November 1951.

DUTCHER CONSTRUCTION CORPORATION (Seal)
P. O. Address Queenstown, Maryland

By RALPH E. DUTCHER (Seal)
Pres.
P. O. Address Queenstown, Maryland

Attest RUTH S. DUTCHER (Seal)
Sec. & Treas.
P. O. Address Queenstown, Maryland

Signed, sealed and delivered
in the presence of

JAMES F. McCLOSKEY
as to both

The aforegoing General Indemnity Agreement was brought to be recorded on June 12, 1956 and recorded in Liber 2 I P #18, folio 154, a Bond Record Book for Queen Anne's County.

T. Sorden Pippin,
Clerk.

[fol. 20]

Exhibit "B" to Petition

PERFORMANCE BOND

(See Instructions on Reverse)

Standard Form 25
Revised November 1959
Prescribed by General
Services Administration
General Regulation No. 5

Date Bond Executed
11 April 1955
4/2/55

Principal
DUTCHER CONSTRUCTION CORPORATION, a Delaware Corporation, of Queenstown, Maryland

Surety
FIRE ASSOCIATION OF PHILADELPHIA, a Pennsylvania Corporation, of Philadelphia, Pennsylvania

Penal Sum of Bond *(express in words and figures)*
One Million Ninety-eight Thousand Nine Hundred Twenty-one and 50/100 ($1,098,921.50) Dollars

Contract No.
DA-30-023-eng-339

Date of Contract
4/11/55
11 April 1955

[fol. 21] KNOWN ALL MEN BY THESE PRESENTS, That we, the PRINCIPAL and SURETY above named, are held and firmly bound unto the United States of America, hereinafter called the Government, in the penal sum of the amount stated above, for the payment of which sum well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally, firmly by these presents.

THE CONDITION OF THIS OBLIGATION IS SUCH, that whereas the principal entered into a certain contract with the Government, numbered and dated as shown above and hereto attached;

NOW THEREFORE, if the principal shall well and truly perform and fulfill all the unddertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then, this obligation to be void; otherwise to remain in full force and virtue.

IN WITNESS WHEREOF, the above-bounden parties have executed this instrument under their several seals on the date indicated above, the name and corporate seal of each corporate party being hereto affixed and these pres-
[fol. 22] ents duly signed by its undersigned representative, pursuant to authority of its governing body,

Corporate Principal
DUTCHER CONSTRUCTION CORPORATION

Business Address
Queenstown, Maryland

By RALPH E. DUTCHER
Title
President
Ralph E. Dutcher

AFFIX CORPORATE SEAL

Attest:

RUTH S. DUTCHER
Secretary
Ruth S. Dutcher

Corporate Surety
FIRE ASSOCIATION OF PHILADELPHIA
Business Address
Philadelphia, Pennsylvania

By JAMES F. McCLOSKEY
Title
Attorney-in-Fact
James F. McCloskey

AFFIX CORPORATE SEAL

Attest:

[fol. 23]

EXHIBIT "C" TO PETITION

PAYMENT BOND

(See Instructions on Reverse)

STANDARD FORM 25-A
Revised November 1959
Prescribed by General
Services Administration
General Regulation No. 5

Date Bond Executed
11 April 1955

Principal
DUTCHER CONSTRUCTION CORPORATION, a Delaware Corporation, of Queenstown, Maryland

Surety
FIRE ASSOCIATION OF PHILADELPHIA, a Pennsylvania Corporation, of Philadelphia, Pennsylvania

Penal Sum of Bond (*express in words and figures*)
Eight Hundred Seventy-nine Thousand One Hundred Thirty-seven and 20/100 ($879,137.20) Dollars

Contract No.
DA-30-023-eng-339

Date of Contract
11 April 1955

KNOW ALL MEN BY THESE PRESENTS, That we the PRINCIPAL and SURETY above named, are held and firmly bound unto the United States of America hereinafter called the Government, in the penal sum of the amount [fol. 24] stated above, for the payment of which sum well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally, firmly by these presents.

THE CONDITION OF THIS OBLIGATION IS SUCH, that whereas the principal entered into a certain contract with the Government, numbered and dated as shown above and hereto attached;

NOW THEREFORE, if the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract, and any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then this obligation to be void; otherwise to remain in full force and virtue.

IN WITNESS WHEREOF, the above-bounden parties have executed this instrument under their several seals on the date indicated above, the name and corporate seal of each corporate party being hereto affixed and these presents duly signed by its undersigned representative, pursuant to authority of its governing body.

Corporate Principal
DUTCHER CONSTRUCTION CORPORATION
Business Address
Queenstown, Maryland

By RALPH E. DUTCHER — AFFIX
Title — CORPORATE
President — SEAL
Ralph E. Dutcher

[fol. 25] Attest:

RUTH S. DUTCHER
Secretary
Ruth S. Dutcher

Corporate Surety
FIRE ASSOCIATION OF PHILADELPHIA
Business Address
Philadelphia, Pennsylvania

By JAMES F. McCLOSKEY
Title
Attorney-in-Fact
James F. McCloskey

AFFIX CORPORATE SEAL

Attest:

IN UNITED STATES DISTRICT COURT

AGREED STATEMENT OF FACTS

The Reliance Insurance Company (formerly known as Fire Association of Philadelphia) upon its petition to this Court, verified September 4, 1959, having duly procured from this Court an order to show cause dated September 21, 1959, requiring the Trustee herein, creditors and others interested in the estate of the above named bankrupt, to show cause before this Court on October 14, 1959, why an order should not be made directing the Trustee herein to forthwith pay over to said Reliance Insurance Company the sum of $87,737.35, being the proceeds of a payment by the U. S. Engineers, received and now held by the T[illegible]
[fol. 26] for work, labor and services rendered and performed by the bankrupt, as the prime contractor, on the St. Lawrence Seaway prime contract, known as Contract No. DA-30-023-eng-339, on which prime contract said Fire Association of Philadelphia—now known as Reliance Insurance Company—was surety under the Miller Act, so-called, 40 U. S. C. A., Secs. 270 ff;

And due and timely notice of said order to show cause having been given to the Trustee, creditors and others interested in the estate of the said bankrupt;

And upon the return day of said order to show cause said Reliance Insurance Company having appeared by its attorneys, Vaughan, Brown, Kelly, Turner and Symons, Mark N. Turner, Esq., of counsel, and Chester A. Pearl-

man, said Trustee having appeared in person and by his attorney, Raymond T. Miles, Esq.;

And there being no other appearances by or on behalf of any creditor or interested person asserting any claim against the aforesaid fund of $87,737.35;

Now, therefore, it is STIPULATED by and between the attorneys for the Trustee and the said Reliance Insurance Company that this Court decide and determine the issues presented by the petition of said Reliance Insurance Company and the order to show cause issued thereon, upon the following facts, which facts are hereby stipulated to be as follows:

1. That Reliance Insurance Company is an insurance corporation duly organized and existing under and by virtue of the laws of the Commonwealth of Pennsylvania, with its principal office and place of business located at 401 [fol. 27] Walnut Street, Philadelphia, Pennsylvania. That the name of the corporation, prior to January 1, 1958, was Fire Association of Philadelphia, and is hereinafter referred to as the "Surety".

2. That heretofore and on or about November 19, 1951, the Dutcher Construction Corporation, the bankrupt herein, made, executed and delivered to the Surety its certain General Indemnity Agreement, a copy of which is annexed to the petition of September 4, 1959, marked Exhibit "A", and is made a part of this stipulation.

3. That on or shortly prior to April 11, 1955, the bankrupt applied to the Surety for payment and performance bonds in connection with a prime contract then about to be entered into between the bankrupt and the United States of America, Corps of Engineers, relating to the St. Lawrence Seaway, and known as Contract No. DA-30-023-eng-339.

4. That in reliance upon Exhibit "A", the Surety, as surety for said bankrupt and not otherwise, on or about April 11, 1955, made, executed and delivered the payment and performance bonds herein referred to, a copy of which Performance Bond is attached to the petition of September

4, 1959, marked Exhibit "B", and a copy of which Payment Bond is attached to the petition of September 4, 1959, marked Exhibit "C", and both of which are made a part of this stipulation.

5. That upon the furnishing to and filing with the Corps of Engineers of said payment and performance bonds, the bankrupt was duly awarded said prime contract and entered upon the performance thereof.

[fol. 28] 6. That thereafter, and on or about April 11, 1956, the United States of America, with the consent of said bankrupt, terminated the aforesaid prime contract of April 11, 1955, and that on or about August 30, 1956, the bankrupt was adjudicated a bankrupt by this Court.

7. That the bankrupt, during its prosecution of said contract and prior to its termination on April 11, 1956, as aforesaid, incurred various bills for labor, materials and services in the performance of its said prime contract, which were covered by the Surety's payment bond, and that prior to April 11, 1956, said bankrupt was in default in the payment of substantial portions of said bills and obligations covered by the Surety's said payment bond.

8. That during the spring and summer of 1956, various demands were made upon the Surety by the several creditors of the bankrupt who were covered by said payment bond, and that pursuant to said demands and in discharge of its obligations and duties under said payment bond, the Surety paid to said beneficiaries under said payment bond the sum of Three Hundred Twenty-Six Thousand Two Hundred Forty-Eight Dollars and Forty-Two Cents ($326,248.42) and, in addition thereto, incurred and paid expenses in connection therewith, in the sum of Twenty Thousand Seven Hundred Fifty-Four Dollars and Thirty-Four Cents ($20,754.34), making a total of Three Hundred Forty-Seven Thousand Two Dollars and Seventy-Six Cents ($347,002.76).

9. That in addition to the foregoing, the Surety paid, in response to a judgment secured against it in the United States District Court for the Northern District of New York, the sum of Eighteen Thousand Eight Hundred Sev-

[fol. 29] enty-Eight Dollars and Forty-Seven Cents ($18,878.47) for tires furnished to the bankrupt for use on said prime contract, by which judgment said Court held the Surety liable therefor, and the further sum of Four Thousand Forty-Five Dollars and Ninety-Two Cents ($4,045.92) to Cradle Equipment, for which the Surety was liable under said payment bond, making a total of claim payments of Three Hundred Forty-Nine Thousand One Hundred Seventy-Two Dollars and Eighty-One Cents ($349,172.81).

That there now remains no known unpaid laborers or materialmen who furnished labor, materials or services in connection with the Dutcher prime contract.

10. That concurrently with the termination of the bankrupt's prime contract, the U. S. Engineers awarded to B. Perini & Sons, Inc. and others, constituting a joint venture, known and referred to as Grass River Lock Constructors, the unfinished portions of the Dutcher prime contract above referred to. That the termination of the Dutcher prime contract; and the addition of the unfinished work thereunder to the preexisting prime contract of Grass River Lock Constructors, was with the full knowledge and consent of the bankrupt.

11. That said Grass River Lock Constructors, in taking over the unfinished work originally included within the Dutcher price contract, agreed with the U. S. Engineers to complete the same at the Dutcher prime contract prices.

12. That concurrently with the termination of the Dutcher prime contract and the taking over of the unfinished work thereunder by Grass River Lock Constructors, said Grass River Lock Constructors entered into an agree-[fol. 30] ment with the bankrupt whereby said bankrupt became a subcontractor for said Grass River Lock Constructors to do and perform certain of the unfinished work originally included in the bankrupt's prime contract; and that for some period of time subsequent to April 11, 1956, the bankrupt performed certain work as a subcontractor of said Grass River Lock Constructors.

13. That said Fire Association of Philadelphia—now Reliance Insurance Company—was not, at any time, a

surety for said Grass River Lock Constructors, nor for the bankrupt herein, at any time while the bankrupt was working as a subcontractor for said Grass River Lock Constructors.

14. That the bankrupt, prior to the termination of its prime contract on April 11, 1956, had earned, in the performance thereof, sums in excess of One Hundred Twenty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($127,737.35). That after said Grass River Lock Constructors undertook the completion of the unfinished work originally included within the Dutcher prime contract, it was asserted by the Contracting Officer for the U. S. Engineers that the proper shaping and dressing of the spoil area was a part of the contract price for excavation, and that Dutcher had not properly completed the work in that respect. That Grass River Lock Constructors asserted it was entitled to be compensated out of the Dutcher prime contract moneys for grading the spoil area onto which the bankrupt had dumped said excavated material while working as a prime contractor.

15. That various conferences were had in which the Trustee herein and his attorney, the Surety herein and [fol. 31] its attorney, Grass River Lock Constructors and its attorney, and the U. S. Engineers and their attorney, participated. That during said conferences it was the consensus of opinion that Forty Thousand Dollars ($40,000.00) was a fair price for doing this work, and represented a fair deduction from the contract price of the Dutcher contract, and a fair addition to the contract of Grass River Lock Constructors for completing the work. That neither the Trustee nor the Surety interposed any objection to Forty Thousand Dollars ($40,000.00) being taken from the Dutcher prime contract moneys and paid to said Grass River Lock Constructors for grading said spoil areas. That thereafter the U. S. Engineers, acting unilaterally, deducted Forty Thousand Dollars ($40,000.00) from the Dutcher prime contract moneys and directed the same be paid to the Grass River Lock Constructors for grading said spoil areas.

16. That the U. S. Engineers, after making the aforesaid Forty Thousand Dollar ($40,000.00) deduction from the Dutcher prime contract moneys, and after satisfying and discharging all its other claims and demands relating to all work performed by the bankrupt under its said prime contract, paid to the Trustee of the bankrupt the sum of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35) for work performed by the bankrupt on its prime contract prior to April 11, 1956, which said sum the Trustee now holds, and which is the subject of this stipulation, and the ownership of which is now before this Court for determination.

17. That subsequent to the bankruptcy of the bankrupt, and within the time required by law, and on or about March [fol. 32] 22, 1957, the Surety duly filed its claim against the bankrupt herein with the Referee in Bankruptcy of this Court, to which reference is hereby made, and which is incorporated herein by reference as though fully set forth herein.

18. That in and by said claim the Surety asserted a first priority: 1) in the aforesaid sum of Three Hundred Forty-Seven Thousand Two Dollars and Seventy-Six Cents ($347,002.76), together with 2) such additional sums as it might pay or be compelled to pay in the discharge of its obligations under the aforesaid payment bond, which amount was, at the time of filing said claim, contingent and unliquidated, but which has now become liquidated and fixed, at least to the extent of the payment of said judgment, in the aforesaid sum of Eighteen Thousand Eight Hundred Seventy-Eight Dollars and Forty-Seven Cents ($18,878.47), and the further sum of Four Thousand Forty-Five Dollars and Ninety-Two Cents ($4,045.92), as aforesaid.

19. That in and by said proof of claim the Surety further asserted:

> "That as to the aforementioned debt, both liquidated, unliquidated and contingent, this creditor claims and asserts it is entitled to priority in the payment thereof,

including by way of liens, subrogation and assignment, from the following sources:

1. Unpaid contract balances, including all estimates, retainages, extras, claims for changed conditions, damages and final estimates unpaid under the bankrupt's aforesaid prime contract with the United States of America, Corps of Engineers, as afore- [fol. 33] said, together with any and all other recoveries, if any, made by the Trustee in Bankruptcy herein on behalf of said bankrupt, growing out of or pertaining in any manner to the aforesaid prime contract with the United States of America, Corps of Engineers."

20. That by virtue of the foregoing, the Surety claims to be the owner of said sum of Eighty-Seven Thousand Seven Hundred Thirty-Seven Dollars and Thirty-Five Cents ($87,737.35), free and clear of the claims of the Trustee in Bankruptcy or any other person, firm or corporation, and claims to be entitled to have said sum paid to it forthwith.

Dated: Buffalo, New York, January ....., 1960.

Raymond T. Miles, Attorney for Chester A. Pearlman, Trustee in Bankruptcy of Dutcher Construction Corporation, Bankrupt.

Vaughan, Brown, Kelly, Turner & Symons, Attorneys for Reliance Insurance Company, Surety.

[fol. 34]

IN UNITED STATES DISTRICT COURT

OPINION OF REFEREE PRIVITERA

Raymond T. Miles, attorney for Trustee.

Vaughan, Brown, Kelly, Turner & Symons; Mark N. Turner, of Counsel, attorneys for Reliance Insurance Co. (formerly Fire Association of Philadelphia).

Saperston, McNaughtan & Saperston; Harry H. Wiltse, of Counsel, attorneys for James F. Mc Closkey, Inc.

Privitera, Referee.

I

This is an application of the Reliance Insurance Company (formerly Fire Association of Philadelphia) for an order directing the trustee to pay to petitioner the sum of $87,737.35, as a priority claim being the proceeds of a payment by the U. S. Engineers, received and now held by the trustee, covering work, labor and services rendered and performed by the bankrupt on the St. Lawrence Seaway Prime Contract, known as Contract No. DA-30-023-eng-339, and on which the petitioner was surety for said bankrupt. Upon due notice to all creditors a hearing was held and opposition to the requested payment was made by the trustee. Thereafter and from time to time this court received letters from several unrepresented creditors opposing the surety's application. Another creditor, James F. Mc Closkey, Inc. was later permitted to appear and oppose the application through its new counsel, since it appeared that the original proof of claim No. 29 (amended by claim No. 55) was previously filed by the surety's counsel who thereafter informed James F. Mc Closkey Inc. of his withdrawal as its counsel when it appeared that a conflict of interest arose.

[fol. 35] On February 15, 1960, the surety and the trustee through their respective counsel entered into a lengthy and detailed written stipulation of facts and incorporated therein as exhibits, copies of the general indemnity agreement between the bankrupt and the surety, and the payment and performance bonds.

II

Briefly, the salient facts of the said stipulation are as follows:

On November 19, 1951, the bankrupt executed and delivered to the Fire Association of Philadelphia its general indemnity agreement.

Subsequently, in 1955 the bankrupt executed a contract with the United States Corps of Engineers relating to the construction of the St. Lawrence Seaway. In connection

with this contract, the bankrupt furnished to the Corps of Engineers payment and performance bonds issued by the Fire Association of Philadelphia on or about April 11, 1955. The latter is now named the Reliance Insurance Company.

The bankrupt entered into performance of its contract with the Corps of Engineers and incurred bills for labor, materials and services which are covered by the surety company's payment bond. Upon the contractor's default in the early part of 1956, the surety company was compelled to pay a number of said bills pursuant to its payment bond. The total so paid was $326,248.42 and the surety further claims expenses in connection with said payments of $20,754.34, and other payments of $22,924.39. [fol. 36] However, on or about April 11, 1956, the United States with the bankrupt's consent terminated its contract with the bankrupt.

Shortly thereafter and on August 30, 1956, the Dutcher Construction Corporation was adjudicated a bankrupt. Concurrently with the termination of the bankrupt's contract with the United States, the latter with the consent of the said bankrupt, awarded the unfinished portion (spoil area) of the bankrupt's contract to Grass River Lock Constructors, a joint venture of several corporations which agreed with the U. S. Engineers to complete the same at the Dutcher prime contract prices. Grass River Lock Constructors, at the time it entered into performance of the work left unfinished by the bankrupt, also agreed to do certain work for the sum of $40,000.00 which work according to the United States should have been done prior to the termination of the bankrupt's contract, said $40,000.00 to be a charge against the sum of $127,737.35 previously earned by the bankrupt and retained by the United States at the time of the termination of the bankrupt's contract. After April 11, 1956, the bankrupt performed work as a subcontractor for the said Grass River Lock Constructors.

However, the Fire Association of Philadelphia, now Reliance Insurance Company, was not, at any time, a surety for said Grass River Lock Constructors, nor for the bank-

rupt herein, at any time while the bankrupt was working as a subcontractor for said Grass River Lock Constructors.

Various conferences were had in which the trustee herein and his attorney the surety herein and its attorney, Grass River Lock Constructors and their attorney and the U. S. [fol. 37] Engineers and their attorney participated. It was the consensus of opinion that $40,000.00 was a fair price for doing this work. That neither the trustee nor the surety objected to this sum being taken from the Dutcher prime contract monies and paid to said Grass River Lock Constructors for grading the spoil areas. Thereafter, the U. S. Engineers, acting unilaterally, paid the said sum to the Grass River Lock Constructors; leaving a balance retained by the United States in the amount of $87,737.35 which was thereafter paid to the trustee.

It is this sum to which the surety company asserts its claim to priority of payment.

III

This case once again brings before this court for determination the claim of a surety for priority payment by way of alleged liens, subrogation and assignment. The difficulty in arriving at a decision stems from the conflicting opinions of the many appellate courts. Prior to the enactment of the Miller Act, it seems in all cases respecting United States Government contracts that the only requirement made of a contractor was that he furnish a performance bond. However, under the Miller Act, the contractor is required to furnish a payment bond and a performance bond. Why the two separate bonds?

A study of the many conflicting opinions shows that a thread of distinction has been made, but not always clearly. In some instances, some courts seem to have made no distinction as to the rights of a surety in the treatment of the circumstances respecting either of the type of bonds, while other courts have made some distinctions.

[fol. 38] Here at least, in the case at bar, we have a clear case involving the payment bond only, since the balance of the contract was taken over by another contractor other than the bankrupt and the bankrupt's surety was not the surety for the other contractor. The surety here, to be

successful in its claim to priority payment, must establish a lien, subrogation rights to one entitled to a priority, or an assignment from one entitled to a priority.

While the surety's proof of claim asserts a priority claim by way of lien, no argument has been made in the various memoranda presented to this court, nor does one seem to exist under any theory from the stipulated facts herein.

Generally, in a construction contract between private parties those who furnish labor and/or materials and supplies have under state laws a right to a lien on the improvement and land which must be perfected in accordance with statutory provisions to secure payment of their claims.

However, when a construction of a project is undertaken by a contractor for the United States Government, no liens can be filed by laborers or materialmen and the United State Government is under no legal liability to pay laborers or materialmen. Since the latter are denied the right to assert liens, the United States Congress, in order to afford them some protection passed the Miller Act, which carries forward prior similar acts in addition to enlarging upon them by requiring the contractor to furnish two bonds, a payment bond for the payment of laborers and materialmen, and a performance bond to guarantee the faithful completion of the job at the contract price. See Miller Act, 49 Stat. 793, 40 U. S. C. A. Sec. 270a *et seq.*; *National Surety Corp.* v. *United States*, 133 F. Supp. 381.

[fol. 39] Since the laborers and materialmen have no right to a lien by reason of the foregoing, they do not occupy any better position than that of general creditors against a contractor. Hence, when the surety is called upon to pay these claims, it is merely paying claims of general creditors. It follows, therefore, that since the laborers and materialmen have no liens or right to liens in Miller Act cases that the surety upon payment pursuant to the payment bond cannot under any theory claim a lien either. *Phoenix Indemnity Company* v. *Earle*, 218 F. 2nd 645 (1955); *American Surety Company of New York* v. *Hinds*, 260 F. 2nd 366 (1958).

Let us now pass to the claims of subrogation and/or assignment. One of the few clear cut cases which brings into sharp focus the rights of a surety who furnished a

payment bond is MATTER OF MILE HIGH PLUMBING & HEATING CO., BANKRUPT, CASE No. 14797, originating in the United States District Court for the District of Colorado in the Tenth Circuit and decided by Referee B. C. Hilliard, Jr. The facts in that case are clearly similar to those in the case at bar.

This well-reasoned opinion is reported on Page 65 of the 1958 April issue of The Journal of National Association of Referees in Bankruptcy. This decision was affirmed by the District Court and upon appeal was unanimously affirmed by the Tenth Circuit United States Court of Appeals on October 11, 1958 *sub nom. American Surety Co. of N. Y.* v. *Oscar Hinds*, 260 F. 2nd 366.

In that case as in the case at bar, the single question presented was: Did the surety by reason of its payment [fol. 40] of labor and material bills incurred by the contractor prior to its adjudication as a bankrupt acquire any rights to the net contract funds superior to the rights of the trustee?

The answer to that question in this case must of necessity be the same as in that case.

> "The rights of a surety are largely derivative in nature. Having paid the laborers and materialmen, appellant may claim subrogation to their rights. But since laborers and materialmen have no enforceable rights against the United States (*U. S.* v. *Munsey Trust Co.*, 332 U. S., Page 241) the surety can rise no higher than the basis of the subrogation. The very purpose of the payment bond required under the Miller Act is to shift the ultimate risk of non-payment from the workmen and the suppliers to the surety." *American Surety Co. of N. Y.* v. *Hinds, supra.*

In other words, the United States does not retain funds for the purpose of assuring payment to laborers and material suppliers since "it seems more likely that completion of the work on time is the only motive". See citations in Munsey case, *supra*, at Page 243.

The court in the Hinds case, *supra*, in Footnote 5 at Page 368 states: "We are not required to consider whether a

different rule might be applicable were a claim made under a performance bond."

It may well be that under a payment bond the surety is to be considered as a guarantor, assuming the risk for a premium payment to pay laborers and suppliers of material who have no lien rights against the United States Government in cases where the Government is the owner. [fol. 41] But, however, to point up the distinction, for the sake of clarity, it may be suggested that under a performance bond, the situation might be different since the surety takes over *completion* of the construction in substitution of the defaulting contractor and hence, is primarily responsible in creating the fund to which it becomes entitled over the trustee, assignees of the bankrupt, etc., absent any right to set-off by the Government. See Phoenix Indemnity Co. v. Earle, *supra*. And, even where the contractor had completed 94.86% of the agreed work before bankruptcy, but the job was completed by the trustee, the court in the Hinds case denied relief to the surety who paid all of the material and labor bills incurred by the contractor.

The holding in the Hinds case, *supra*, is firmly supported by the Munsey case, *supra*. In fact, the Munsey case uses much stronger language in dispelling the notion that a surety can become entitled to priority payment by way of subrogation, when it states at Page 242:

> "In relying on the rights of the laborers and materialmen, however, the surety must establish that those rights existed before their claims were paid. For it is elementary that one cannot acquire by subrogation what another whose rights he claims did not have. *Once the laborers and materialmen have been paid, either by the contractor or surety, they have no rights in any fund.* If before they are paid, the fund they are said to be entitled to look is unavailable for the very reason that they are unpaid, the surety relies on nothing when it relies on these nonexistent 'rights'. One who rests on subrogation stands in the place of one whose claim he has paid, as if the payment giving rise to the [fol. 42] subrogation had not been made. *See Aetna Life Assurance Co. v. Middleport*, 124 U. S. 534, 548.

> He cannot jump back and forth in time and present himself at once as the unpaid claimant, and again, under the conditions as they have changed, because payment was made."

See Pages 243-244, Munsey case, where the court in unmistakable language stated:

> "On the contrary, the statutory provisions requiring a separate bond for payment of laborers and materialmen were enacted for their benefit, not to the detriment of the Government. *It is the surety who is required to take the risk.* In the case of the laborers' bonds, the surety has promised that they will be paid, not as in the case of the performance bond, that work will be done at a certain price. The law of damages is, therefore, not pertinent to the payment bond."

The situation apparently is different where a surety in a Miller Act case takes over the *completion* of the contract under the performance bond and furnishes new and contemporaneous consideration sufficient to support collection of payments due on account of the contract. *Pacific Indemnity Co. v. Grand Avenue State Bank of Dallas,* 223 F. 2nd 513, C. C. A. 5th 1955. This is even true where a surety finances and supervises the contractor's operations to complete the contract at the contract price. *Massachusetts Bonding and Ind. Co., v. State of New York,* 259 F. 2nd 33, C. C. A. 2nd July 11, 1958.

If the Munsey case means what it says, the retained percentage or other monies which the Government holds (or [fol. 43] turns over to the trustee) not being a fund held by the Government for the benefit of the laborers or materialmen, since it owes them nothing, but the said fund is held for the purpose of insuring the faithful performance of the contract *in toto,* and the said fund is nonexistent insofar as the laborers and materialmen are concerned, and that the said claimants are only general creditors under the Miller Act, that the surety, upon demand to fulfill its obligation under the payment bond, is doing nothing more than required under the calculated risk it undertakes in con-

sideration of the premiums paid it by the contractor, and that upon payment by it to the claimants, it becomes subrogated, if at all, to the said claimants' rights as general creditors only, in an ensuing bankruptcy proceeding.

Thus the surety is not being denied payment as such, but it shall stand in no better position than those it has paid or other general creditors of the bankrupt, excepting in a case where laborers or other recognized wage earners may be entitled to priority payment for wages earned within three months of the filing of a petition in bankruptcy. Sec. 57 i and Sec. 64 a (2) Bankruptcy Act.

The point is that the surety does not become entitled to any specific fund held by the Government, the bankrupt contractor or the trustee, since the fund as such does not exist for that purpose. See Munsey case and Hinds case, *supra*.

True the surety may stand in the shoes of the laborers and materialmen, call it subrogation or assignment. But the surety only holds a general claim against general assets held by the trustee and no preferred claim against a specific fund, or the cream of the general assets.

[fol. 44] The surety in its memoranda to this court, among other cases and in support of its position urges the application of the so-called Fago case which originated in this court and was finally decided by the Second Circuit *sub nom. Massachusetts Bonding and Insurance Co. v. State of New York*, 259 F. 2nd 33 (1958). That case is most interesting because of the varied problems presented therein. While there are many points of similarity to the case at bar, there also are many features of that case that are clearly distinguishable. It, in fact, supports the position of the trustee herein.

On the matter of subrogation, that case holds *inter alia*, that where the United States asserted its set-off right to satisfy the payment of taxes due it from the bankrupt out of money earned by the bankrupt, that the surety did not acquire any right of subrogation to the position of the United States, for it said on page 36:

> "But the surety cannot establish this fact, for under the doctrine of *United States* v. *Munsey Trust Co.*

> * * *, neither the bankrupt nor the surety ever became entitled to those funds, so that there was nothing for the surety to own. In short, the surety by way of subrogation might be entitled to progress payments and retained percentage, due its principal *if the surety completes the job after the principal's default.* (Citing numerous authorities.)"

The point made above is twofold; first, that neither the bankrupt nor the surety ever became entitled to those funds since the retained percentages are held as assurance for the completion of the contract, so that there was nothing for the surety to own, and second, that there is a definite [fol. 45] distinction in regard to rights and remedies of a surety who does not complete the contract as against a surety who does.

In the Massachusetts case, *supra*, while surety was denied subrogation to the Government's position after the Government availed itself of its set-off, the court in allowing the surety to recover the $9,500.00 from the trustee did so in the finding, first that the surety caused the *completion* of the job by financing it, and second that there was a conversion of those monies which were originally earned by the surety during the progress of the job's *completion.*

There is a parallel situation in the Massachusetts case with the Munsey case. In the former, the court held that since neither the bankrupt nor the surety ever owned the "retained percentages" fund, that therefore, there could be no subrogation when the government asserted its right to set-off, while in the latter, the court held that since the "retained percentages" fund was non-existent as far as laborers and materialmen were concerned, that the surety could be entitled to no more than them.

It is the reasoning in the United States Supreme Court Munsey case which is adopted by the Massachusetts case and the Hinds case, that is controlling in determining the issue in the instant case. All other cases cited by the surety in its memoranda are not controlling, but are distinguishable inasmuch as they deal with situations affecting a determination of rights between the sureties and assignees of the bankrupt, cases decided under statutes antedating

the Miller Act; and also situations where the sureties *completed* the contracts in addition to making payments to [fol. 46] laborers and materialmen. Most of these cases are also distinguished or discredited in the Munsey and Hinds cases.

IV

As stated in the Munsey case, that the United States does not hold the "retained percentages" fund for the purpose of assuring payment to laborers and material suppliers since "it seems more likely that the completion of the work on time is the only motive", it can then be said that the key to the surety's rights to that fund, absent the right of the government to set-offs, and proper claims of other parties, is the completion of the contract. To put it another way, the funds are held "*in terrorem*" and in a state of suspension awaiting the final satisfactory completion of the contract by the contractor at the contract price. These funds do not become due and payable until that time.

When the surety pays the suppliers of labor and material pursuant to its obligations under the payment bond (for which it received cash consideration in the premium paid to it by the contractor) it is merely extinguishing the risk which it undertook to guarantee their payment under the Miller Act.

If on the other hand, these same payments were made while the surety was fulfilling its obligation under the performance bond; then and in that event, absent again the government's right of set-off, and proper claims of other parties, the surety would under the Massachusetts case doctrine, become entitled to the said "retained percentages" fund.

[fol. 47] It is to be noted that the Munsey case did not limit itself to a discussion of the payment bond. It did in very clear language state *inter alia* that a job must be completed by the contractor at its contract price, before the "retained percentages" can be paid to it. However, although the Hinds case squarely had the same problem presented before it as in the case at bar, it limited its decision to a discussion of the payment bond only. It did not venture to digress by *obiter dictum*, if it would be such,

"whether a different rule might be applicable were a claim made on a performance bond". In doing so it can be said that the court properly limited itself to an adjudication of the precise point before it. However, since it had an opportunity to do so, and had it discussed the surety's right under a performance bond in augmenting its decision, it would indeed have aided and facilitated the present task of this court. Where appeals are frequent there should be a strong tendency by the appellate courts in these modern times to fortify the judgment rendered, with every principle that can be invoked in its behalf, those that are collateral as well as those that are necessarily involved. It is not infrequent in the courts of last resort where there are many judges, that while a court may come to one and the same conclusion, that nevertheless various views might be expressed by different judges. These views, while they might sometimes be philosophical, they none the less to a great degree enhance the strength of the rendered judgment. The above, of course, is unnecessary to this opinion, but it is offered by way of explanation and not apology why this court did discuss some aspects of the performance bond.

Since a case on a lower court originates on a broader base, it is felt that such a discussion places this decision [fol. 48] relating to the rights of a surety under a payment bond, in better perspective. It is difficult to attempt to render a decision on one without an understanding of the other, since both bonds are required simultaneously when a Miller Act contract is awarded.

V

I conclude, therefore, that where a surety who furnishes a payment bond to assure payment to laborers and suppliers of material of a contractor engaged in construction work for the United States Government and which bond is furnished pursuant to the requirements of the Miller Act, whereunder the said laborers and materialmen cannot file liens against the government owner or the contractor, and the said contractor has not *completed* its contract or the surety has not completed the same or caused it to be com-

pleted, that the said surety upon making payments to the laborers and materialmen pursuant to its payment bond becomes subrogated to the rights of the said laborers and materialmen as a general creditor only in their place and stead, and where funds held by the government are turned over to the trustee in bankruptcy, the said surety which made the payments aforesaid does not become entitled to a priority in advance of general creditors, except possibly for claims of those wage earners that it has paid which wages might have been earned within the limits of the statutory three months period preceding the filing of a petition in bankruptcy.

VI

The foregoing having been considered upon the stipulated facts and conclusions of law drawn therefrom, it is

[fol. 49] Ordered, that the application of the Reliance Insurance Company (formerly Fire Association of Philadelphia) directing the trustee to pay to it the specific sum of $87,737.35, the proceeds received from the United States Engineers as a priority claim be and the same hereby is denied, and it is further

Ordered, that the said claim be and the same hereby is allowed as a general claim, excepting that portion of the claim which can be proven as an assignment of wages in accordance with the statute.

James R. Privitera, Referee in Bankruptcy.

Dated at Buffalo, New York, January 9, 1961.

It Is So Ordered.

IN UNITED STATES DISTRICT COURT

PETITION TO REVIEW REFEREE'S DECISION—
January 13, 1961

To Honorable James R. Privitera, Referee in Bankruptcy:

The petition of Reliance Insurance Company (formerly Fire Association of Philadelphia) respectfully represents:

1. Your petitioner is aggrieved by the Order-Opinion of James R. Privitera, Referee in Bankruptcy, dated January 9, 1961, a copy of which is annexed hereto, marked Exhibit "A", and made a part hereof.

2. The referee erred with respect to said order as follows:

[fol. 50] (a) In that he failed to direct the payment to petitioner of the sum of $87,737.35, as the property of the petitioner.

(b) In that he failed to award the item referred to in sub-paragraph "(a)" hereof to petitioner, by way of its lien, subrogation and/or assignment rights.

(c) In that he failed to award the aforesaid sum as a priority claim.

(d) In that he relegated petitioner's claim with respect to the said $87,737.35 to the status of a general creditor.

(e) In that he failed to grant to the petitioner the relief to which it was entitled.

Wherefore, petitioner prays that the Order be reviewed by a Judge in accordance with the provisions of the Act of Congress relating to bankruptcy. That said Order be modified in accordance with the specifications herein set forth, and that your petitioner have such other and further relief as is just.

Dated: January 13, 1961.

Reliance Insurance Company, By Addison Roberts,
Its Vice President.

Vaughan, Brown, Kelly, Turner & Symons, Attorneys for Petitioner, By Mark N. Turner, Partner, Office & P. O. Address, 440 M & T Building, Buffalo 2, New York.

[fol. 51] To:

Hon. James R. Privitera, Referee.

Raymond T. Miles, Esq., Attorney for Trustee.

Saperston, McNaughtan & Saperston, Attorneys for James F. McCloskey, Inc.

IN UNITED STATES DISTRICT COURT

REFEREE'S CERTIFICATION OF RECORD ON REVIEW—
January 27, 1961

To the Honorable Judges of the District Court of the United States for the Western District of New York:

I, James R. Privitera, Referee in Bankruptcy herein, on the Petition to Review an order dated January 9, 1961 made by me hereby certify as follows:

1. Petition for Review of Reliance Insurance Company (formerly Fire Association of Philadelphia), dated January 13, 1961.

2. Opinion and Order of Referee dated January 9, 1961.

3. Agreed statement of Facts between Counsel dated February 15, 1960.

4. All copies of Exhibits considered in the Opinion are transmitted separately and consist of the following which are attached to and made part of the original petition and order to show cause dated [fol. 52] September 24, 1959 and returnable on October 14, 1959:

   Exhibit A—General Indemnity Agreement
   Exhibit B—Performance Bond
   Exhibit C—Payment Bond

The questions presented are the alleged errors of law set forth in the Petition for Review, the facts not being controverted.

Respectfully submitted,

James R. Privitera, Referee in Bankruptcy.

Dated: January 27, 1961.

In United States District Court

Letter to Judge Henderson From Referee Privitera Enclosing Amended Proof of Claim

COPY

February 3, 1961

Hon. John O. Henderson,
United States Courthouse,
Buffalo 2, New York.

Re: Dutcher Construction Corp. No. 41068

Dear Judge Henderson:

Enclosed please find amended Proof of Claim, No. 133 of the Fire Association of Philadelphia whose name was later changed to Reliance Insurance Co.

[fol. 53] This proof of claim should be considered along with the other exhibits forwarded. It was referred to in the stipulation of facts entered into by Counsel and ~~enclosed~~ incorporated therein by reference.

Respectfully yours,

James R. Privitera, Referee in Bankruptcy.

Enc.

In United States District Court

Amended Proof of Claim—Filed in Bkcy. Court March 22, 1957

Claim No. 133

At Philadelphia, in the District of Pennsylvania, on the 21st day of March, 1957, came Peter J. Korsan of 327 Callendar Lane, Wallingford, in the County of Delaware and Commonwealth of Pennsylvania, and made oath:

That he is the Secretary and Counsel of Fire Association of Philadelphia, an insurance corporation incorporated under and by virtue of the laws of the Commonwealth of Pennsylvania, with its principal office and place of business located at 401 Walnut Street, Philadelphia, Pennsylvania, and that he is duly authorized to make this proof.

That this claim is an amended claim to supplant its claim previously filed herein.

[fol. 54] That said Dutcher Construction Corporation, the corporation against whom a petition for adjudication in bankruptcy has been filed or made was at and before the filing of said petition, and still is justly and truly indebted to said corporation in the sum of $358,287.92.

That the consideration of said debt is as follows:

Losses paid as surety for the bankrupt on bankrupt's prime contract with the United States of America, Corps of Engineers, for certain work, labor and materials in connection with the St. Lawrence Seaway, being known and described as Contract No. DA-30-023-eng-339, to date as follows:

Claims paid	$326,248.42	
Expense payments	20,754.34	
		$347,002.76

Losses paid as surety for the bankrupt on bankrupt's subcontract with Johnson, Drake & Piper, Inc., in connection with the construction of a portion of the New York State Thruway in the vicinity of Westfield, New York, to date as follows:		
Claims paid	$ 8,408.18	
Expense payments	2,876.98	
		$ 11,285.16
Grand Total		$358,287.92

[fol. 55] That in addition thereto, Fire Association of Philadelphia is and may be liable and compelled to pay on either or both of said bonds, as surety for said bankrupt, as aforesaid, additional losses and expenses, the amount and extent of which is not known and cannot be ascertained by this creditor at this time, and that this portion of this creditor's claim is filed as a contingent and unliquidated claim pursuant to Section 57d of the Bankruptcy Act.

That no part of said debt has been paid, that there are no set-offs or counterclaims to the same, and that this creditor has not nor has any person by its order or to the knowledge or belief of deponent for this creditor's use had or received any manner of security and for said debt whatever; that no judgment has been rendered on said debt; nor has any note been received for such account.

That said claim with respect to the liquidated portion thereof consists of numerous claims asserted against this claimant under the two (2) bonds referred to above given as surety for said bankrupt, and that the maturity date of said debts are various, commencing on or about June 15,

1956 and subsequent thereto, and that no note has been received nor judgment recovered therefor.

aforementioned debt,

That as to the ~~following portion of the above debt,~~ both liquidated, unliquidated and contingent, this creditor claims and asserts it is entitled to priority in the payment thereof, including by way of liens, subrogation and assignment, from the following sources:

1. Unpaid contract balances, including all estimates, retainages, extras, claims for changed conditions, damages and final estimates unpaid under the bank- [fol. 56] rupt's aforesaid prime contract with the United States of America, Corps of Engineers, as aforesaid, together with any and all other recoveries, if any, made by the Trustee in Bankruptcy herein on behalf of said bankrupt, growing out of or pertaining in any manner to the aforesaid prime contract with the United States of America, Corps of Engineers.

2. Unpaid contract balances, including all estimates, whether retained or otherwise, and final balances, recovered or received by the Trustee in Bankruptcy herein, arising out of or pertaining in any manner to the bankrupt's sub-contract with Johnson, Drake & Piper, Inc., herein above referred to, together with any claims for extras, additional compensation or otherwise, arising out of said sub-contract.

That this deposition is not made by the claimant in person because claimant is a corporation and that this deponent is duly authorized by his principal to make this affidavit, and that it is within his knowledge that the aforesaid debt was incurred as and for the consideration above stated; and that such debt to the best of his knowledge and belief still remains unpaid and unsatisfied.

The undersigned creditor of the above named bankrupt hereby authorizes Brown, Kelly, Turner & Symons to attend any and all meetings of creditors of the bankrupt

aforesaid for and in the name of the undersigned, to vote for or against any proposal or resolution that may then be submitted under the Acts of Congress relating to bank-
[fol. 57] ruptcy; and in the choice of Trustee or Trustees of the estate of said bankrupt; and for the undersigned to assent to such appointment of Trustees; also to accept any composition proposed by said bankrupt in satisfaction of his debts, and to receive payment of dividends; and of money due the undersigned under any composition; and for any other purpose in the undersigned's interest whatsoever with full power of substitution.

In Witness Whereof, the undersigned claimant has caused this Claim to be subscribed by its duly authorized officer and its corporate seal to be hereunto duly affixed the day and year above stated.

Fire Association of Philadelphia, By P. J. Korsan, Its Secretary & Counsel.

(Seal)

Duly sworn to by Peter J. Korsan, jurat omitted in printing.

[fol. 58]

IN UNITED STATES DISTRICT COURT

DECISION—September 12, 1961

Vaughan, Brown, Kelly, Turner & Symons (Mark Turner, of Counsel), Buffalo, New York, Attorneys for Petitioner, Reliance Insurance Company.

Miles, Cochrane & Grosse (Ray Miles, of Counsel), Buffalo, New York, Attorneys for Trustee in Bankruptcy.

The Reliance Insurance Company has petitioned for the review of a decision of the Referee in Bankruptcy relegating it to the position of a general creditor on claims for losses incurred under a payment bond given pursuant to the Miller Act, 49 Stat. 793 (1935), 40 U. S. C. §270a (1958).

The Miller Act is the most recent of a series of acts designed to protect laborers and materialmen working on

government projects by requiring general contractors for the government to provide a surety bond guaranteeing payment of wages and material bills. Unlike the former legislation in the field,[1] the Miller Act separates the obligation of the general contractor to its laborers and materialmen from its obligation to the United States for the completion of the contract, accomplishing this by requiring two bonds—each designed to guarantee the respective obligation covered—in place of the single, combination performance and payment bond previously required. This change enhanced the bond protection of the laborers and materialmen by shortening the time within which they had to wait before suing on the bond and by divorcing the laborers' or materialmen's claim against a surety from any change of [fol. 59] consequences attendant upon the contractor's performance or non-performance of the construction contract itself.[2]

The surety in the case at bar rests its claim for priority upon a number of federal court cases beginning with *Henningsen* v. *United States Fidelity and Guaranty Company*, 208 U. S. 404 (1908), which recognized the right of a surety which had paid labor or material bills pursuant to its surety obligation to obtain recovery against any funds otherwise owing to the contractor by the government, but remaining in the hands of the government. Each of these

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[1] The Heard Act, August 13, 1894, ch. 280, 28 Stat. 278, as amended by Act of February 24, 1905, ch. 778, 33 Stat. 811.

[2] The legislation preceding the Miller Act required the unpaid laborer or materialmen to wait until six months after the government had accepted the completed project, regardless when, during construction, the labor had been performed or the material provided. If at any time prior to this, the United States sued on the surety bond for default in performance of the contract by the contractor, the unpaid laborer or materialman could intervene in the action for the purpose of obtaining relief, but relief on his claim was postponed to that of the United States, and would be nonexistent if the claim of the United States was greater than the total amount of the bond.

[3] See, *e.g.*, *In re* Scofield Co., 215 Fed. 45 (2d Cir. 1914); *In re* P. McGarry & Son, 240 Fed. 400 (7th Cir. 1917); Belknap Hardware & Manufacturing Co. v. Ohio River Contracting Co., 271 Fed. 144 (6th Cir. 1921).

cases, although arising under the earlier legislation, involved situations like that at bar, where the payments made by the surety satisfied the contractor's default in paying labor and material bills and were not incurred by a default in completing the contract. Then, as now, the issue was whether, in providing the bond requirement in the statute, Congress intended to substitute the laborers' action upon the bond for any and all right against the United States or, on the other hand, intended merely to provide "an additional protection, which would become the ordinary and primary one, and usually would be sufficient, and to do this without diminishing the obligation of the government to [fol. 60] see that these claims were paid, as far as that result could be accomplished by the funds which it retained." *Belknap Hardware & Manufacturing Company* v. *Ohio River Contracting Company*, 271 Fed. 144, 148 (6th Cir. 1921). If the equitable right of the laborers and materialmen to look to the fund in the government's hands remained (in addition to the action upon the bond), the surety paying the laborers and materialmen could recover.

The answer of the courts before the enactment of the Miller Act was in favor of the surety. Whether that result has been changed by either the enactment of the Miller Act itself or by the effect of *United States* v. *Munsey Trust Company*, 332 U. S. 234 (1947) is the determinative issue in this case.

The enactment of the Miller Act would not seem to have affected the holding of the prior federal cases. Examination of the provisions of the legislation and of the discussions which took place on the floor of Congress when the Miller Act was passed[4] indicates that the purpose of Congress at that time was to remove certain loopholes in the bond protection previously accorded to laborers and materialmen—not to alter the fundamental rights and duties as between sureties, laborers and materialmen, and the government. Under the new legislation, laborers and materialmen could sue a surety upon a payment bond after

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[4] 79 Cong. Rec. 11702 (1935) (remarks of Representative Miller); 79 Cong. Rec. 13382 (1935) (remarks of Senators Burke, Walsh and McCarran).

waiting only ninety days after the labor was performed or the material furnished [40 U. S. C. § 270b], rather than being required to wait until six months after the entire project had been completed and accepted by the govern- [fol. 61] ment. Moreover, under the new arrangement, satisfaction of the laborers and materialmen under the bond was not conditioned, as before, upon the prior satisfaction —perhaps by exhaustion of the penal sum of the bond itself—of the government for any default in performance of the contract. I conclude that the precedents antedating the Miller Act are as appropriate now, as before, unless, as the Referee held and as the Trustee now urges, the effect of the *Munsey* decision was to overrule the *Henningsen* line of authority.

While some cases support the Referee's decision on this point,[5] there is also considerable authority to the contrary.[6] In *Munsey*, the Supreme Court was confronted with a claim by a surety against funds held by the government which would have been due to the contractor, but for a set-off claimed by the government against the contractor. The United States was not in that case a mere stakeholder with no interest of its own to press, as it was in the *Henningsen* case and also here until it paid the sum to the trustee in bankruptcy. The holding in *Munsey*—that the government's

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[5] American Surety Co. v. Hinds, 260 F. 2d 366 (10th Cir. 1958); Phoenix v. Earle, 218 F. 2d 645 (9th Cir. 1955); Fidelity & Deposit Co. v. N. Y. Housing Authority, 140 F. Supp. 298 (S. D. N. Y. 1956), rev'd on other grounds, 241 F. 2d 142 (2d Cir. 1957). Compare State Bank of Albany v. Dan-Bar Contracting Co., Inc., 23 Misc. 2d 487, 199 N. Y. S. 2d 309 (S. Ct. 1960), aff'd 12 A. D. 2d 416, 212 N. Y. S. 2d 386 (3d Dep't 1961).

[6] Cummins Construction Company, 81 F. Supp. 193 (D. C. Md. 1948); United States Fidelity and Guaranty Company v. Triborough Bridge Authority, 297 N. Y. 31 (1947); Royal Indemnity Company v. United States, 93 F. Supp. 891 (Ct. Cl. 1950); Hadden v. United States, 132 F. Supp. 202 (Ct. Cl. 1955); National Surety Corporation v. United States, 133 F. Supp. 381 (Ct. Cl. 1955), *cert. den.* 350 U. S. 902 (1955); Continental Casualty Company v. United States, 169 F. Supp. 945 (Ct. Cl. 1959); Newark Insurance Company v. United States, 169 F. Supp. 955 (Ct. Cl. 1959); Bank of Arizona v. National Surety Corporation, 237 F. 2d 90, 93 (9th Cir. 1956) (*dictum*).

claim to set-off was superior to the claim of a surety—does not require a conclusion that where the United States has [fol. 62] no set-off claim, the surety has no superior rights to the funds over general creditors. Indeed, such an extension of the *Munsey* decision would unwarrantably increase risk to the surety, whose guarantee has played a direct part in the production of the bankrupt's income here at issue and would further increase expense to the government through increased bond premiums passed on by the contractor as a cost of doing business. It seems sufficient to note that at no point in the *Munsey* decision did the Court mention *Henningsen* or the line of decisions which follow it. Had the Court intended by its language in *Munsey* to discard this prior authority, it is at least reasonable to assume that some discussion on the point would have been had.

The Referee's decision is set aside and his order of January 9, 1961, is vacated. The application of the Reliance Insurance Company for an order directing the trustee to pay to it the specific sum of $87,737.35, the proceeds received from the United States Engineers, as a priority claim is granted.

So ordered.

Dated: September 12, 1961.

John O. Henderson, United States District Judge.

[fol. 63]

IN UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF NEW YORK

In the Matter

of

DUTCHER CONSTRUCTION CORPORATION, Bankrupt.

In Bankruptcy No. 41068

NOTICE OF APPEAL FROM JUDGE HENDERSON'S OPINION—
September 21, 1961

Notice is hereby given that Chester A. Pearlman, as Trustee in Bankruptcy, hereby appeals to the United States Court of Appeals for the second circuit from the order of Judge John O. Henderson entered the 12th day of September, 1961, which order reversed the decision of the Referee entered January 9, 1961, and granted the petition of the Reliance Insurance Company.

Buffalo, Sept. 21, 1961.

Raymond T. Miles, Attorney for Chester A. Pearlman, Trustee in Bankruptcy, Dutcher Construction Corporation, Office & Post Office Address, 942 Ellicott Square Building, Buffalo 3, New York.

[fol. 64] To:

Vaughan, Brown, Kelly, Turner & Symons, Attorneys for Reliance Insurance Company, Office & Post Office Address, 440 M & T Building, Buffalo, New York.

Saperston, McNaughtan & Saperston, Attorneys for James F. McCloskey, Inc., Office & Post Office Address, Liberty Bank Building, Buffalo 2, New York.

[fol. 65]

IN UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In the Matter
of
DUTCHER CONSTRUCTION CORPORATION, Bankrupt.

No. 41068

STIPULATION CONCERNING THE RECORD—October 17, 1961

It Is Hereby Agreed and Stipulated by the respective attorneys for the parties herein, that all the papers cited in the Index on this appeal are the matters to be considered on this appeal and all other papers not so cited, are excluded.

October 17, 1961, Buffalo, N. Y.

Raymond T. Miles, Attorney for Chester A. Pearlman, Trustee in Bankruptcy of Dutcher Construction Corporation, Bankrupt.

Mark N. Turner, Vaughan, Brown, Kelly, Turner & Symons, Attorneys for Reliance Insurance Company.

[fol. 66]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 197—September Term, 1961,

Argued January 19, 1962

Docket No. 27246

In the Matter

of

DUTCHER CONSTRUCTION CORPORATION, Bankrupt.

Before: Medina, Moore and Smith, Circuit Judges.

Appeal from an order of the United States District Court for the Western District of New York, in bankruptcy, John O. Henderson, Judge.

The trustee in bankruptcy appeals from an order directing him to pay to petitioner, Reliance Insurance Company, $87,737.35, a fund previously paid to the trustee by the United States for work performed by the bankrupt on its prime Government contract prior to the termination of said contract by mutual consent on April 11, 1956. The payment was directed on the basis of the subrogation of Reliance Insurance Company to priority rights of materialmen and laborers, who had been paid by Reliance Insurance Company pursuant to the terms of its payment bond, upon [fol. 67] the failure of the bankrupt to make such payments when due. Opinion below reported at 197 F. Supp. 441. Affirmed.

Raymond T. Miles, Buffalo, New York, for appellant, Chester A. Pearlman, Trustee in Bankruptcy of Dutcher Construction Corporation.

Mark N. Turner, Buffalo, New York (Vaughan, Brown, Kelly, Turner & Symons, Buffalo, New York, on the brief), for respondent, Reliance Insurance Company.

John G. Street, Jr., Fort Worth, Texas, filed a brief as *amicus curiae* supporting the contentions of appellant.

Thomas W. Murphy, Phoenix, Arizona (Murphy & Mirkin, Phoenix, Arizona), filed a memorandum as *amicus curiae* supporting the contentions of appellant.

OPINION—February 6, 1962

MEDINA, Circuit Judge:

The trustee in bankruptcy of Dutcher Construction Corporation appeals from an order of Judge Henderson, reversing the Referee and holding that petitioner-appellee Reliance Insurance Company (formerly named Fire Association of Philadelphia) was entitled to a fund of $87,737.35 previously paid by the Government to the trustee. Opinion below reported at 197 F. Supp. 441.

The case is interesting and important, as it involves the controversial question of whether a surety, having paid materialmen and laborers pursuant to the terms of a payment bond, but not having completed performance of work required by the prime contract with the Government, is [fol. 68] entitled by way of subrogation to the fund paid to the trustee in bankruptcy by the Government for the work done by the contractor prior to the termination of the contract. We think the legal principles formulated by the courts on this subject under the Heard Act, 28 Stat. 278 (1894), amended 33 Stat. 811 (1905), were not affected or altered by the Miller Act, 49 Stat. 793 (1935), 40 U. S. C. Section 270a, which superseded the Heard Act. With all due respect to our brothers of the 9th and 10th Circuits, we believe they have misconstrued the Supreme Court decision in *United States* v. *Munsey Trust Company*, 1947, 332 U. S. 234, and we disagree with the decisions in those Circuits holding the surety not entitled to subrogation. *Phoe-*

nix v. Earle, 9 Cir., 1955, 218 F. 2d 645; *American Surety Co. v. Hinds*, 10 Cir., 1958, 260 F. 2d 366.

The facts are stipulated. In April of 1955 Dutcher contracted with the United States to perform work on the Saint Lawrence Seaway project. Prior to awarding the contract, the Government required Dutcher to supply the customary surety bonds, a performance bond and a payment bond. This was done pursuant to the Miller Act, 40 U. S. C. Section 270a, which provides:

> "Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as 'contractor':
>
> (1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.
>
> [fol. 69] (2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person."

Reliance is the surety on these bonds.

On April 11, 1956 the Government, with the consent of Dutcher, terminated the contract. During the preceding year Dutcher incurred obligations to pay for labor and materials in the performance of the contract. Dutcher did not meet these obligations. The surety did pay them, in the amount of $326,248.42, for labor and materials, and additional sums for expenses, and in satisfaction of a judgment against the surety for tires furnished for use on the job, amounting in all to $349,172.81. These bills were paid by the surety in the Spring and Summer of 1956. At the end of August, 1956 Dutcher was adjudicated bankrupt.

Prior to the termination of the contract, Dutcher had earned, after Government deductions, $127,737.35 for the

work done up to that time, and this represented the labor and materials that had gone into the job. This sum, owing to Dutcher, was reduced by $40,000, the cost to the Government of completing the job. This consisted of the proper shaping and dressing of the spoil area. The balance, $87,737.35, was paid by the Government to appellant, as Trustee for Dutcher. The surety petitioned for an order in bankruptcy directing the transfer of this fund to the surety. The Referee, relying upon *Munsey* and the *Hinds* decision by the 10th Circuit denied the petition, and Judge Henderson reversed the Referee and held the surety entitled to the fund by subrogation. We affirm.

All parties agree that the surety is subrogated to the rights of the laborers and materialmen. What this entitles [fol. 70] the surety to is hornbook law and is set forth in Osborne, Suretyship (1955) at page 20, "It * * * entitles the surety to enjoy any priority that the creditor enjoyed." See also Restatement, Security §141, comment c. (1941). Thus, the only question in this case, and the decisive one, is—were the laborers and materialmen entitled to a priority in the $87,737.35?

Under the Heard Act

The Heard Act required a contractor entering on the construction of any public work for the United States shall "execute the usual penal bond, with good and sufficient sureties, with the additional obligations that such contractor or contractors shall promptly make payments to all persons supplying him or them labor and materials in the prosecution of the work provided for in such contract." 33 Stat. 812 (1905). In *Henningsen v. U. S. Fidelity & Guaranty Co.*, 1907, 208 U. S. 404, the surety which had paid materialmen and laborers upon the contractor's failure to do so, claimed a fund due from the Government as against a creditor of the contractor who held an assignment. It was argued by the creditor that the surety had no right prior to the assignment as the materialmen and the laborers had no lien on the Government property under construction, as the contractor and not the surety had completed performance under the contract, and as the material-

men and the laborers never had any right to the fund. In rejecting these contentions the Supreme Court held, 208 U. S. at page 410:

> "It [the surety] paid the laborers and material-men and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that the [fol. 71] laborers and supply men were paid. It did this not as a volunteer but by reason of contract obligations entered into before the commencement of the work."

This would seem to be plain enough. But *Henningsen* was commented upon in *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.*, 6 Cir., 1921, 271 Fed. 144, and the priority of materialmen and laborers spelled out in no uncertain terms, at pp. 148-9:

> "In that case [Henningsen], the surety upon a bond of this kind [a payment bond], given pursuant to the 1894 statute, and who had been compelled to pay its surety obligation, was held entitled to priority in the retained fund as against a general creditor of the contractor. * * * The surety's claim of priority in the fund was sustained, and this was done on the stated theory of subrogation. Since there cannot be the transfer of a right by subrogation, unless there is a right to be transferred, we think the necessary effect of the decision is to hold that the laborers and materialmen, in spite of or in addition to the giving of the bond, had an original and continuing equitable priority in the fund, and that it was this right to which the surety was subrogated."

The Miller Act

It is common knowledge that difficulties and inconveniences arose in the application of the Heard Act. For example, the unpaid materialmen and laborers had to wait until six months after the completion and final settlement of the contract before they could proceed against the surety.

If the Government instituted suit earlier, the laborers and materialmen could intervene, but shared only in the balance, if any, of the surety's liability remaining after the amount due the Government was paid in full. The legisla- [fol. 72] tive history of the Miller Act indicates clearly that the separate performance and payment bonds in their present form were substituted for the old law for the further protection of materialmen and laborers. See 79 Cong. Rec. 11702 (1935) (remarks of Representative Miller); 79 Cong. Rec. 13382 (1935) (remarks of Senators Burke, Walsh and McCarran). There is nothing to indicate that the priorities of the materialmen and laborers were intended to be eliminated, or affected in any way by the new provisions of the Miller Act. Under the Heard Act, and under the Miller Act as well, the security for the materialmen and laborers was to stand in place of a lien on the property under construction, as no lien attaches to Government property. The purpose under each of these Acts was the same, to encourage laborers and those furnishing materials to undertake the construction of the Government facility, and to make sure that those who did so and created the product under construction should be secured out of the job itself rather than on the general credit of the prime contractor.

It follows we think that the same priorities held to exist under the Heard Act continue to exist under the Miller Act. If the Government was under "equitable obligations to see that the laborers and supply men were paid" (208 U. S. at page 410), this would seem sufficient to support the claim of the surety for priority, and such "equitable obligations" surely are not less under the Miller Act than they were under the Heard Act. In this context we think it quite immaterial that, after the termination of the contract, the little that remained to be done to complete the job was not done by the surety.

United States v. *Munsey*, 1947, 332 U. S. 234.

The decisions of the 9th and 10th Circuits in *Phoenix* and *Hinds* above referred to are based squarely on the premise [fol. 73] that the Supreme Court in *Munsey* had sustained

the Government's claim to a set-off partly because of "the weakness of the surety's claim to equitable rights in the fund." See *Hinds*, 260 F. 2d at page 368. Perhaps this impression stems from the following dictum in *Munsey*, 332 U. S. at page 242:

> "We need not decide whether laborers and materialmen would have any claim to the retained percentages if both contractor and surety failed to pay them. Even if they do, certainly those would be rights to which the surety could not be subrogated, for by hypothesis it would have done nothing to earn subrogation."

In any event, we think the quotations from *Munsey* in the opinions in *Phoenix* and *Hinds* have been misconstrued. If the Supreme Court intended to make any comment with respect to the situation now before us, it was merely to say they held the point open for decision in the future. Of course, if the surety failed to pay materialmen and laborers, the surety "would have done nothing to earn subrogation." Moreover, the fact that "laborers and materialmen have no enforceable rights against the United States," 260 F. 2d at page 368, is beside the point. The question is not whether the laborers and materialmen have rights enforceable against the Government, but whether they have an equitable priority in the retained payments.

In *National Surety Corporation* v. *United States*, Ct. Claims, 1955, 133 F. Supp. 381, cert. denied sub nom. *First National Bank in Houston* v. *United States*, 1955, 350 U. S. 902, the Court said at page 384:

> "[T]he laborers and materialmen have the equitable right to assert a claim to moneys in the hands of the defendant [the United States] which are due the contractor. When the surety pays the laborers and ma- [fol. 74] terialmen, it becomes subrogated to their right to assert an equitable claim to the moneys in the hands of the defendant. It has frequently been held that they have equitable priority to these moneys over the general creditors of the contractor and over his assignees. [Numerous citations omitted.]

> In *United States* v. *Munsey Trust Co., supra*, the Supreme Court said that the United States was not legally liable to laborers and materialmen, but it did not say that laborers and materialmen could not assert an equitable claim to moneys in the hands of the United States payable under the contract. We think they can. To permit them to do so in no way interferes with the full exercise of the sovereign powers of the United States. It does not subject the defendant to liability beyond the amount it has in its hands confessedly due and owing to somebody."

Royal Indemnity Co. v. *United States*, Ct. Claims, 1950, 93 F. Supp. 891, is to the same effect.

The principle established by *Munsey* was that the Government's right to a set-off based on sums due from the contractor on other jobs was superior to any claim of the surety by way of subrogation. Furthermore, there is language in *Munsey* that justifies, if not compels, it to be limited to situations in which the United States is asserting a claim of its own to the retained funds. There are cases that have so held. E.g. *Royal Indemnity Co.* v. *United States, supra*; *United States Fidelity & Guaranty Co.* v. *Triborough Bridge Authority*, 1947, 297 N. Y. 31; and cases cited in *Hinds*, 260 F. 2d at 368.

It is inconceivable to us that the Supreme Court intended in *Munsey* to overrule *sub silentio* the rules of priority and [fol. 75] subrogation that, as we have already pointed out, were so well established under the Heard Act. Certainly, there is not the slightest intimation that anything in the Miller Act was intended to change priorities existing under the prior legislation. See *United States* v. *Aetna Casualty & Surety Co.*, 2 Cir., decided January 11, 1962, [illegible] Sheet, at page 622. Accordingly, we disagree with *Phoenix* and *Hinds*.

We hold the surety entitled to the fund by subrogation; and the order appealed from is affirmed.

[fol. 76]

In United States Court of Appeals

For the Second Circuit

Present: Hon. Harold R. Medina, Hon. Leonard P. Moore, Hon. J. Joseph Smith, Circuit Judges.

In the Matter

of

Dutcher Construction Corporation, Bankrupt,
Chester A. Pearlman, Trustee, Appellant.

Judgment—February 6, 1962

Appeal from the United States District Court for the Western District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Western District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

[fol. 77] [File endorsement omitted]

[fol. 78] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 79]

SUPREME COURT OF THE UNITED STATES

No. 771, October Term, 1961

CHESTER A. PEARLMAN, Trustee, Petitioner,

vs.

RELIANCE INSURANCE COMPANY.

ORDER ALLOWING CERTIORARI—April 16, 1962

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Frankfurter and Mr. Justice White took no part in the consideration or decision of this application.